



**Final Minutes
Endowment Fund Investment Board (EFIB) Regular Meeting
February 18, 2004**

The regular meeting of the Endowment Fund Investment Board was held on Wednesday, February 18, 2004. Chairman Dean Buffington called the meeting to order at 10:34 a.m. and recognized that a quorum was present.

Members Present:

M. Dean Buffington
Gavin M. Gee
Thomas F. Kealey
Senator Brad J. Little
Dr. Richard L. Miller
William D. Mitchell
R. John Taylor
Parker G. Woodall

Staff Present:

Matthew J. Haertzen
Connie M. Eshelman
Andrew M. Potter
Angela R. Zirschky

Members Absent:

Representative William W. Deal

Guests:

James Alcorn, State Insurance Fund
Steve Allison, State Controller's Office
Doug Bates, Clearwater Investment
David Boren, Clearwater Investment
John Pickett, RBC Dain Rauscher
Bill Reese, Judges' Retirement System
Richelle Sugiyama, PERSI

1. Minutes of the December 08, 2003 Regular Meeting: Approved

Dr. Rick Miller joined the regular session at 10:40 a.m. during the review of the December 08, 2003 meeting minutes

Parker Woodall recommended that a comma be removed from the last sentence in the first paragraph under State Insurance Fund Reports (page 1) to make it a complete sentence and that Small Cap Value and Mid Cap Growth be dropped from Strong Capital Management's title in the first sentence under Manager Summaries (page 1).

Pending these changes, a motion was made by Parker Woodall, second by Bill Mitchell to approve the December 08, 2003 meeting minutes. The motion carried unanimously.

2. State Insurance Fund (SIF) Reports: *Staffed by Matthew Haertzen, Investment Manager, EFIB and John Pickett, RBC Dain Rauscher*

Senator Brad J. Little departed the meeting at 10:52 a.m. during the State Insurance Fund Report

John Pickett outlined the results of the 4th quarter 2003 market returns and the one-year returns as of December 31, 2003. Additionally, Mr. Pickett reported on the performance of equities during past presidential cycles and noted that the first and second year cycle averages are significantly lower than third and fourth year averages.

The State Insurance Fund total portfolio is in-line with policy and is structured with 12% equities exposure and 88% in fixed income and cash. Total market value of the equity portion as of December 31, 2003 was reported at \$43,879,194.49 and total market value of the fixed income as of December 31, 2003 was reported at \$291,278,903.26. The cash market value as of December 31, 2003 was \$4,695,328.48 for a total account value of \$339,853,426.23.

Manager Review

Mr. Pickett reported that Oppenheimer Capital Mid-Cap Value during 4th quarter 2003 made several portfolio adjustments, initiating several new health care positions including Inveresk Research Group and Laboratory Corp. of America. Oppenheimer Capital believes that these positions, among others, will benefit from what they expect to be a continued economic recovery.

Chairman Dean Buffington acknowledged James Alcorn from the State Insurance Fund and opened the floor for questions.

3. Judges' Retirement System (JRS) Reports: *Staffed by Matthew Haertzen, Investment Manager, EFIB*

Mr. Haertzen reported that equity manager Tom Johnson Investment Management, Inc. was terminated and replaced with Russell 3000 I shares. Legislation is currently underway to help diversify the portfolio and to amend existing law allowing the Endowment Fund Investment Board to set an investment policy subject to approval of the Supreme Court and that the JRS investment board may select and contract with banks and trust companies authorized to do business in Idaho who may not necessarily be located in Idaho.

No concerns were noted for Rainier Investment Management, Inc.

Mr. Haertzen acknowledged Bill Reese from the Judges' Retirement System and Chairman Dean Buffington opened the floor for comments or questions for Mr. Reese.

4. Endowment Fund

A. Performance and Update: *Staffed by Matthew Haertzen, Investment Manager, EFIB and John Pickett, RBC Dain Rauscher*

Mr. Pickett reported that the Endowment Fund's total portfolio is in-line with policy. Mr. Pickett also noted that one year numbers revealed significant returns from the portfolio's managers.

Total market value of the equity as of December 31, 2003 was reported at \$551,592,120.52 and total market value of the fixed income as of December 31, 2003 was reported at \$201,911,504.57. Market value of the cash as of December 31, 2003 was \$3,416,149.11 for a total account value of \$756,919,774.20.

Manager Review

Mastrapasqua: Mastrapasqua cites several positive economic factors to justify higher equity valuations going forward.

Met West: Met West continues to find value opportunities despite the recent surge in the market. Met West believes that their current portfolio is undervalued and should continue to provide greater market returns going forward.

Artisan: Artisan believes that their move to larger companies toward the end of 2002 hurt relative performance in 2003 as smaller and more speculative stocks posted better results. Going forward, they expect investors to pay more attention to risk and believe continued modest economic improvement is likely.

Oppenheimer: Oppenheimer made several portfolio adjustments, initiating several new health care positions.

Systematic: Systematic cites several positive economic indicators including increased manufacturing, strengthening employment, and low inflation that they believe point to strong growth prospects in 2004.

Nicholas Applegate: Nicholas Applegate continues to find a wealth of attractive opportunities in the market which they believe bodes well for future strong performance. Mr. Pickett noted that he is concerned about the company's high personnel turnover and will closely monitor any possible impacts it may have on the firm.

Lazard: Lazard believes that investors will turn away from the more volatile cyclical stocks toward companies with strong fundamentals. Mr. Pickett noted that RBC Dain Rauscher has recommended reviewing Lazard. This review is underway and ongoing.

Marvin and Palmer: Marvin and Palmer believes that the economic recovery is sustainable due to increasing corporate spending and profitability. They are concerned about the recent decline of the US dollar and that an uncontrolled decline could precipitate a currency crisis.

B. Staff Reports - Staffed by Matthew Haertzen, Investment Manager, EFIB

Mr. Haertzen reported that the Endowment Fund's market value has shown an increase from \$662,848,364 as of June 30, 2003 to \$756,296,830 as of December 31, 2003.

January revealed a solid month for earnings reserve dollars, and Mr. Haertzen reported that the Endowment Fund is on pace to make the full public school payout.

Endowment Fund Investment Board year-to-date expenses as of December 31, 2003 show the fund has spent 40.47% of its budget. Mr. Haertzen informed the board that the Endowment Fund's lease is up in January 2005 and efforts are underway to lease office space from the Department of Lands with occupancy to commence July 01, 2004 with rent to begin in February 2005. Rent for the new office space will be slightly less than the current lease payment. Expenses for the new office space will be paid for in this budget year.

C. Legislative Update - Staffed by Matthew Haertzen, Investment Manager, EFIB

Mr. Haertzen reported that the Endowment Fund is tracking the following legislation during the 2004 session:

House Bill H0508a - Judges' Retirement Fund: Out of amending order and should be voted on in the House by February 20, 2004.

House Bill H0509 – Permanent Endowment Funds, Investment: Passed the House with the presentation to the Senate State Affairs scheduled for February 23, 2004.

Senate Bill S1238 – Capital Endowment Funds, Deposits: Passed the Senate and will be presented in the House February 19, 2004.

Senate Bill S1306 – Permanent Endowment Funds, Investment: Scheduled for second reading February 18, 2004.

Budget Hearing: Unanimous approval of the Endowment Fund's budget by the Joint Finance and Appropriation's Committee (JFAC)

Mr. Haertzen also reported that Gubernatorial appointments for Chairman M. Dean Buffington, Representative William W. Deal, Senator Brad J. Little, and Dr. Richard L. Miller were approved February 17, 2004 in the Senate.

D. Commission Recapture: Approved - Staffed by Connie Eshelman, Investment Officer, EFIB

Ms. Eshelman explained that commission recapture is a way to reduce commission costs and retain more capital by utilizing a directed brokerage program that will rebate a portion of the trading commissions directly back to the Endowment Fund. The recapture will be reviewed on an annual basis and will:

1. Utilize two trade commission recapture brokers
2. Trade only on best price and execution
3. Target 30% of total for EFIB managers
4. Monitor risk control by monthly reporting from recapture brokers, and
5. Provide contracted set fee schedule

A motion was made by Parker Woodall with a second by Gavin Gee to implement the commission recapture program in March as presented. The motion carried unanimously.

E. Futures Overlay: Approved - Staffed by Doug Bates and David Boren, Clearwater Advisors, LLC:

Bill Mitchell departed the meeting at 11:45 a.m. during the Futures Overlay Report and did not participate in the vote.

Doug Bates and David Boren of Clearwater Advisors explained that the futures overlay objective is to maintain full equitization of both operational and residual manager cash to minimize the impact of cash drag on the portfolio. This will allow the Endowment Fund to build up cash reserves to fund beneficiary distributions while reducing the performance impact of carrying cash and reducing the transaction costs of investing the money in the interim.

Execution will entail \$3-5 million managed by Clearwater Advisors in short-term investments to provide the collateral for the overlay strategy. Clearwater Advisors will receive a daily electronic

download from Northern Trust showing the available cash in the operations account and investment manager's accounts, as well as any pending trade settlements. Futures will then be purchased to synthetically invest the cash according to the asset allocation targets in the EFIB Investment Policy Statement.

Daily reporting will be provided on current futures position. Monthly reporting will be provided detailing the tracking error of the futures contracts from the portion of the account trying to be equitized. Fees include 15 basis points of the average value of cash equitized annually.

A motion was made by Gavin Gee with a second by Dr. Rick Miller to approve the futures overlay as presented. The Motion carried unanimously.

Chairman Dean Buffington recommended a departure from regular session at 12:05 a.m. for lunch. Regular session reconvened at 12:20 p.m.

F. New Small Cap Value Manager Barrow Hanley: Approved - Staffed by John Pickett, Consultant, RBC Dain Rauscher and Matthew Haertzen, Investment Manager, EFIB:

Senator Brad Little joined the regular session at 12:25 p.m. during the Small Cap Value Manager Update and participated in the vote.

Bill Mitchell joined the regular session at 12:30 p.m. during the Small Cap Value Manager Update and participated in the vote.

Mr. Pickett reported that the small cap value manager search was initiated after the Endowment Fund Investment Board terminated Strong Capital Management.

The firms were brought before the Endowment Fund Investment Board's Executive Committee in January to interview with a resulting recommendation to hire Barrow-Hanley out of Dallas, Texas as the new small cap manager.

A motion was made by Gavin Gee with a second by Tom Kealey to approve Barrow Hanley as the new small cap manager. The motion carried unanimously.

G. May Manager's Summit – Staffed by Matthew Haertzen, Investment Manager, EFIB

Mr. Haertzen outlined the agenda for the Manager Summit scheduled for May 11, 2004 at the Grove Hotel following the Joint Land Board Meeting. The summit's objective is to have the Endowment Fund's portfolio managers come and provide a 15 minute presentation outlining why we should invest in their asset class.

H. Custodial Transition – Staffed by Connie Eshelman, Investment Officer, EFIB and Matthew Haertzen, Investment Manager, EFIB

Ms. Eshelman reported that Northern Trust Funds, Inc. has made the custodian transition very easy and the transition is on schedule. Representatives from the Endowment Fund, State Insurance Fund, and Judges' Retirement fund will participate in a training session with Northern Trust scheduled for February 23 and 24, 2004.

I. Worldcom Update: Approved – Staffed by Matthew Haertzen, Investment Manager, EFIB

Mr. Haertzen reported that February 20, 2004 is no longer the opt out date for the Worldcom litigation. The recommendation from the Attorney General's office as of February 2, 2004 was to stay with the Class Action.

A motion was made by Senator Little with a second by Bill Mitchell to revise the Endowment Fund Investment Board's previous position on participating with the Class Action and defer the decision to the Executive Committee to approve based on forthcoming recommendations from the Attorney General's office. The motion carried unanimously.

J. Policy/Procedure Manual: – Staffed by Matthew Haertzen, Investment Manager, EFIB
Approved

Mr. Haertzen asked the board to review the proposed policy/procedure manual and sign their annual Independence Requirement Statements. A recommendation was made by Parker Woodall on the Audit Policy to revise the verbiage in the Audit Policy stating that a Request for Proposal (RFP) will be issued in October of the year before the current audit contract expires. Gavin Gee recommended that the policy on air pollution currently in draft format at the Endowment Fund be incorporated into the manual when completed.

Pending the above changes, a motion was made by Gavin Gee with a second by Dr. Rick Miller to approve the Endowment Fund Investment Board's Policy/Procedure Manual.

5. Executive Session: *Idaho Code § 67-2345* authorizes the board to enter into Executive Session for the purpose of discussing possible legal actions *§ 67-2345(1)(f)* or personnel issues *§ 67-2345(1)(b)*. Any resulting action will take place when the board resolves back into regular session.

The motion was made by Parker Woodall, second by Dr. Rick Miller to enter into Executive Session. The roll call vote was as follows:

Dr. Rick Miller – Aye
Gavin Gee - Aye
John Taylor - Aye
Tom Kealey – Aye
Parker Woodall – Aye
Senator Brad Little – Aye
William Mitchell – Aye
Chairman Dean Buffington – Aye

The motion carried unanimously.

Regular Session convened at 1:30 p.m.

The motion was made by Parker Woodall, second by Senator Brad Little to grant Mr. Haertzen a \$1,000 bonus and to permanently raise his pay grade to schedule V with an increase in pay to \$55.60 per hour for the remaining eight pay periods in fiscal year 2004.

There being no further business to come before the Board, the motion was made by Gavin Gee, second by Dr. Rick Miller to adjourn the meeting at 1:32 p.m. The motion carried unanimously.